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THESIS

BUSINESS ETHICS

by

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BUSINESS ETHICS

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ABSTRACT

The Polish public procurement and the Polish Ministry of Defense (MOD) acquisitions programs have been subject to frequent violations and abuses since the public procurement system was introduced in Poland in 1995.

The complex Polish economic situation and the MOD's budget constraints call for tools that allow public money to be managed properly. This thesis examines the laws and regulations binding the public procurement in Poland along with current ethical concerns that the MOD has encountered. This thesis further recommends elements of an Ethics Program, which the Polish MOD should adopt and implement within its procurement organizations.

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EXECUTIVE SUMMARY

Poland endured over 120 years of occupation followed by the Cold War. These events diminished Poland's sensitivity to ethics. Values like ethics became scarce within the Polish Government, industry and private sectors.

Since 1989, Poland has been experiencing a transition from a centrally planned economy to a free market, which has required the nation to adjust its laws to international standards. These changes have tremendously influenced the behavior of the Government officials and businessmen. As a result of these changes, the Polish Government introduced the Act on Public Procurement in 1995, creating a uniform public procurement system and implementing a precise legal framework for competition among organizations interested in public contracts. The Act requires full and open competition and clear dissemination of information. This Act also applies to the Ministry of Defense procurement programs.

Though a legal basis exists for transparent public procurement, Polish procurement has experienced numerous incidents in the last few years that call for implementing ethics programs that will support regulations and provide guidance in areas not covered by laws.

Reports of the Supreme Audit Chamber and the World Bank along with surveys of the Polish public provide numerous examples of law violations and unethical business practices. Abuses of special tendering procedures by the MOD procurement organizations, suspicions of bribery or instances of negligence characterize the environment of the Polish public procurement.

The purpose of this thesis is to examine the current ethical environment of the MOD procurement programs along with the laws and policies governing them, to determine if the MOD procurement organization should develop and implement an ethical program. In addition, this thesis also recommends what elements this program should include.

This thesis reviews and analyzes the laws and regulations that bind public procurement and the MOD when procuring goods, services and construction projects. The thesis provides the results of interviews that were conducted with fourteen industry managers and various MOD procurement officials. The research focuses on the MOD and the Government-owned companies conducting business with the MOD. This research also analyzes reports of auditing agencies and media articles to evaluate current ethical issues.

This thesis presents facts revealed during the research and analyses the collected data. These studies further present the recommendations for implementing an ethics program within the MOD. Lastly, this thesis also provides a model of the ethical program along with its essential elements.

I. INTRODUCTION

A. BACKGROUND

The Polish public procurement system, introduced in 1995 with the Public Procurement Act, established a precisely described framework for organizations responsible for using taxes to procure goods and services. The Act requires full and open competition and a clear and precise dissemination of information. The Ministry of Defense (MOD) acquisition programs are subject to this Act.

In the Polish environment, the financial existence of many companies depends on funds received through Government contracts. Therefore, much is at stake when contracts with the MOD are considered. In this situation, companies and individuals sometimes display greed and collusion and compete intensely for MOD contracts. As a result, the public has become increasingly interested in how public money is spent. Additionally, in the last few years Polish procurement has experienced numerous incidents of unethical business conduct.

Corruption can undermine the rule of law, tax compliance, respect for contracts, civil order and safety, and ultimately the legitimacy of the state itself (Ref.22).

The MOD is in a unique situation to influence local economies since it spends a significant portion of the Polish budget. When a considerable budget deficit exists, "it is essential to create a system that will be resistant to disruptions" (Ref.12).

Furthermore, the MOD and its officials should be free from suspicions of misconduct.

If government officials and military personnel conduct themselves unethically, it would bring shame on the MOD, where "Honor and Homeland" must be the highest values (Ref.12).

As part of the NATO alliance, it is incumbent upon Poland to have a transparent system that allows Poland's allies to trust its Government. Thus Poland must implement an ethical program within the MOD acquisition community by increasing international cooperation and conforming Polish law and regulations to international standards.

B. PURPOSE

The purpose of this thesis is to analyze the current ethical issues involved in the Polish MOD acquisition programs and to propose an Ethical Program. Additionally, this thesis will develop an Ethics Program Implementation Model for the Polish MOD.

C. RESEARCH QUESTIONS

This thesis research will answer the following Primary and Subsidiary questions:

1. Primary

What is the current ethics environment within the Polish acquisition programs and given that environment, what should be the essential elements of a formal ethics program for the Ministry of Defense (MOD)?

2. Subsidiary

a. What specific guidance does Polish Law provide with respect to ethics, business conduct and personal standards of conduct?

b. How does the MOD implement and regulate ethical conduct within its acquisition personnel and defense contractors?

c. How does the Polish industry approach ethical issues when conducting business with the MOD?

d. What ethical issues currently ensue during industry and the MOD procurement?

e. Based upon the current situation in Poland, what should be the essential elements of an MOD ethics program?

D. SCOPE

The scope of this thesis is limited to analyzing the Polish MOD environment and the existing MOD acquisition programs. The thesis focuses on the Polish industry and its approach to ethical issues. It also analyzes how the MOD approaches ethical conduct by considering problems the MOD procurement programs experience.

E. METHODOLOGY

The methodology used for this thesis includes a literature review and search of Polish Law, regulations, documents, and Internet sources. In addition, a review of existing MOD regulations and policies was conducted. Lastly, telephone interviews with industry managers and military procurement officials were conducted.

F. LIMITATIONS

1. MOD

Access to key individuals within the Polish MOD and Polish Armed Forces chain of command is limited, as these

organizations have been known to constrain external surveys and interviews.

2. Industry

Some of the industry managers were unavailable owing to their scheduling and traveling obligations. Moreover, some industry managers were reluctant to discuss ethical issues over the phone. They asked for e-mailed or faxed survey questions; their responses may be empirically flawed due to their fear of recrimination.

G. ORGANIZATION OF STUDY

Chapter II begins with an overview of regulatory guidelines and current practices regarding the ethical concerns. Chapter III discusses the current ethical issues experienced by MOD acquisition programs.

Presentation of the data and its analysis are addressed in Chapter IV. This chapter also describes the MOD's current ethical initiative.

Chapter V provides conclusions based on the research results presented in Chapter II and Chapter III and presents a model for implementing an ethics program within the Polish MOD. Furthermore, this chapter answers the primary and secondary research questions.

H. CHAPTER SUMMARY

This first chapter describes the current ethical environment within Poland and the need to reform the Polish MOD procurement system. The next chapter examines the regulatory guidelines and current practices regarding the ethical concerns, focusing on Polish Law, the MOD regulations, the Polish business approach to ethics and the

results of audits that different organizations have conducted.

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II. OVERVIEW OF REGULATORY GUIDELINES AND CURRENT PRACTICES REGARDING ETHICAL CONCERNS

A. GENERAL

This chapter summarizes Polish laws and regulations currently in force, concerning ethics, standards of conduct and conflict of interests.

When discussing ethics, it is important to understand that a different perception of ethics exists in every culture. Additionally, laws and regulations peculiar to every country create diverse environments for ethics.

Acquisition officials possess the power to decide how public funds are used when procuring for construction projects and goods and services; therefore the existence of tools that assure the proper use of that power is extremely important. These tools are essential when a nation transforms from a centrally planned economy to a free market and must subsequently adjust the laws to international standards.

B. OVERVIEW OF EXISTING LAW AND PROCUREMENT REGULATIONS IN POLAND

1. Polish Law

Poland is a republic with governmental power divided into legislative, executive and judicial branches. The legislative power comes from a democratically elected Parliament, consisting of an upper house, the "Senat" and the lower house, the "Sejm." The executive power is entrusted to the President of Poland and the Council of Ministers. The national courts and tribunals possess judicial power.

In Poland three sources of law exist: the Constitution, the statutes, and the regulations.

Statutes, issued by the Sejm, are the primary binding laws in Poland. Next in line are regulations, which can be issued only by entities defined in the Constitution. Such organs are the President of the Republic of Poland, the Council of Ministers, the Chairman of the Committee, who is a member of the Council of Ministers, and the ministers who manage the specific department in the public administration (Ref.19).

These acts and regulations mentioned above, very precisely describe the procedures as well as the duties and responsibilities of relevant personnel. The authors of "Report: Proposed Blueprint for Polish National Acquisition Strategy," succinctly stated: "No law; no authority." The following statement drawn from this report clearly defines and limits the authority of all government entities:

The rights of each individual and the authority of the Government, or correspondingly of government officials must be specified by statute, both as to definition of the right or authority and the same concomitant method of execution, i.e., "*Nulle leage sine potentiatus*" (Ref.10).

2. Public Procurement Act

The public procurement system was introduced in Poland in 1995 with the Act on Public Procurement of June 10, 1994. The Act provided uniform and transparent procedures and a precise legal framework for the competition between entities applying for public contracts. The main principle of this Act was fair and open competition. It also required the equal treatment of competitors and clear, precise

disclosing of information. Since its introduction, the Act has been amended to clarify rules and definitions, broaden its scope, and assure decentralization and transparency.

The Act addresses ethical concerns in Article 19 and Article 20 and their recent amendments of Chapter 3, "Principles of Awarding Public Procurement Contracts."

Article 19 excludes potential contractors who were sentenced for crimes such as bribery, or any other crime committed to gain financial profit while engaged in procurement proceedings. Article 19 also excludes contractors currently employing any personnel sentenced for the above-mentioned crimes. Also excluded are entrepreneurs who were fined for unfair competition or for bribery of a public official.

Article 20 briefly addresses conflicts of interest and post-employment concerns.

a. The Office of Public Procurement

The Office of Public Procurement was created on January 1, 1995, as an agency within the Polish government. The Chairman, who heads the Public Procurement Office, is the central organ in the state administration responsible for all matters of public procurement. An advisory body to the Chairman is a Council, composed of Members of Parliament, associations of suppliers and contractors. State review institutions and experts in public procurement are also members of the Council.

One of the primary roles of the procurement office is training; however, this training is limited to

arbiters' training and a general advisory role in a broad spectrum of procurement issues.

The Office of the Public Procurement calls for developing and implementing of an ethical code for public procurement organizations (Ref.18).

3. Other Regulations

a. The Public Finance Act

The Public Finance Act of November 28, 1998, with later amendments of November 14, 2001, addresses violations of public financing policies. In fact, the entire Chapter V of this Act details the rules and procedures addressing misconduct of government officials who are responsible for spending public funds. As stated in the Act, public procurement officers are subject to this Act, including MOD procuring personnel. check alignment all the way through

This Act presents an extremely prescriptive approach leaving no room for interpretation or personal judgment. For instance, the Act defines concept of public funds, legal forms budget parties, planning and management, auditing procedures along with duties and responsibilities of entities that govern public funds. Chapter V also describes forms of punishment and appropriate procedures in case of law violations.

b. The Limited Entrepreneurial Activities of Public Officials Act

This Act of August 21, 1997 addresses issues of entrepreneurial activities of public officials. The purpose of this Act is preventing public officials from being involved in situations that could undermine their objectivity and honesty. Furthermore, the Act intends to

create trust in the government organizations and ensure transparency of the public procurement. The Act applies to all currently employed government officials. One of the intents of this act was limiting benefits of government employees. The Act concerns only members of the Parliament and higher Government officials. In the MOD, the Act concerns only the Minister of Defense, vice-ministers and heads of the MOD's departments.

c. Penal Code

In a report based on the results of the conference on combating corruption in Poland, held in Washington, in 1999, the authors described the current corruption problems and the court and criminal law institutions. They generated changes in the Polish Penal Code, which more effectively fought corruption and safeguarded integrity.

With reform of the Polish Law, particularly the Penal Code in 1997, the Polish Government created tools useful in combating law violations. Penalties for bribery increased and a penalty for bribing foreign officials was added. Additionally, regulations regarding dishonest competition and new banking laws provided the means to make the governing of public funds more transparent (Ref.5).

C. MINISTRY OF DEFENSE REGULATIONS

Beyond other acts and regulations, military personnel in Poland are subject to the "General Military Regulation." Three major regulations are as follow:

- Military Service Act, June 30,1970
- Military Discipline Act, September 4, 1997

- Financial Responsibility of Military Personnel Act, August 28, 2001

Besides the "General Regulation," each of these three Acts addresses standards of conduct but very briefly. The last two Acts primarily describe procedures and forms of punishment in case laws and regulations are violated (Ref.4 and Ref.7).

1. Procurement Regulations

The Polish Ministry of Defense is the main procuring organization of major weapon systems, goods, construction projects and services.

The MOD procuring activities are subject to the Public Procurement Act. The Civil Code and the Trade Code also apply to the MOD acquisition programs. Within the Polish MOD, departments such as the Budget Department, the Armed Forces Procurement Department, the Armament Policy Department and the Infrastructure Department are involved in acquisition activities; however, the main two participants are the Armed Forces Procurement Department and the Budget Department.

The Armed Forces Procurement Department (AFPD) when procuring goods and services and authorizing construction projects must obey the Public Procurement Act, the Civil Code and the Trade Code (Ref.13). The AFPD procures in compliance with the binding acts and regulations and internal procedures developed and based on these acts and regulations. "Since January 1, 2002 the Budget Department has become part of the process as the Level III Budget Holder, with the authority to sign contracts and invoices" (Ref.13).

a. Implementation

The AFPD conducted over 500 proceedings in FY 01, which required the same number of review boards, each consisting of at least three personnel. "The purpose of those actions was to protect against protests, disputes or even the appearance of illegalities" (Ref.11).

The Armed Forces Procurement Department implemented internal procedures, guidelines, regulations and the Code of Professional Responsibilities. Any violator of these laws immediately loses credibility and will likely be dismissed from his or her position. "There is no room for tolerance of violations" (Ref.11). Furthermore, an internal audit, functioning within the Armed Forces Procurement Department mandates strict compliance with the Procurement Act and other regulations. According to Col. Nowak, the Head of the AFPD, the perception of proper conduct is not the only important outcome. More important are transparent procedures in compliance with binding regulations.

One recent change regarding the transparency of procuring activities was adding a requirement to catalogue exactly what commercial items were within the threshold of the specifications (Ref.11).

b. Training

As mentioned before, the AFPD conducts significant number of procuring activities. Each of its officers was involved in the proceedings of 25 review boards in FY 01. This represents a tremendous workload and responsibility.

Col. Nowak stated that the selection process and training are keys to success. Continuous training is being implemented within the AFPD. This training addresses current issues that the MOD acquisition programs may encounter. Col. Nowak highlighted that disseminating information was one of the most important aspects in the training process (Ref.11).

2. Land Forces Regulations

The Land Forces Command (LFC) partially conducts procurement activities as a component of the decentralized acquisition programs. Within the LFC, five departments conduct different procurements. They are as follows:

- Technical Directorate
- Material Directorate
- Health Care Directorate
- Transportation Directorate
- Infrastructure Directorate

It is important to underline that these organizations focus mainly on procuring goods, services and construction projects, and their role is rather limited.

As mentioned in Chapter I, the Polish military chain of command and the structure of the Armed Forces impose regulations on the subordinate services. "Level II Budget Holders are the commanders of the three services, i.e., the Land Forces (Army), the Air Forces and the Navy, commanders of designated units and heads of the departments that report directly to the Minister of Defense. Level III

Budget Holders are commanders of units that report directly to Level II Budget Holders" (Ref.10).

This means that the procurement organizations of Land Forces are subject to the same acts and regulations as the MOD. The only differences are regulations, procedures and guidelines that the heads of the MOD departments implement internally, such as, the AFPD, and other departments specifically related to the MOD.

3. Ethical Conduct

It is also important to highlight that Polish Law and the other binding acts and regulations described above precisely define the procedures, duties and responsibilities of organizations and individuals involved in public procurement. Furthermore, those acts and regulations are binding for both the government organizations and for all contractors, namely, the Polish industries.

A review of the Polish Law by the researcher showed that the Civil Code and Trade Code do not address ethical concerns, conflicts of interest or standards of conduct. They are, however, very precise legal frameworks for conducting business and resolving disputes.

The Polish encyclopedia describes ethics as a set of norms and moral judgments that are characteristic for a given society (Ref.16). Therefore, perception plays an important role when we discuss ethics. An individual's action could be legal but could still be judged as unethical under society and business norms.

Any record of the existing code of ethics or standard of conduct could not be found within the MOD. The only

guideline addressing ethical concerns within the MOD procuring organizations is the Code of Professional Responsibilities implemented by Col. Nowak. This Code addresses the following ethical issues and conflict of interests (among numerous other concerns that are superfluous to this study) (Ref.14).

- Proceedings in accordance with binding regulations and procedures;
- Objectiveness in solicitations;
- Participation of authorized personnel in product presentations;
- Additional employment of procuring officials;
- Protection of information regarding technical or pricing data;
- Contact with offerors limited only to authorized personnel;
- Prohibition of acceptance gifts or other favors from offerors;
- Conflict of interest concerning members of review boards and selection boards.

This Code applies only to the employees of the AFPD; therefore, it does not apply to the Land Forces Command procurement organizations or any other entities within the MOD. The structure of the MOD and the chain of command of the Armed Forces limit wide implementation of this Code. During interviews, representatives of the LFC did not confirm the existence of any additional, internal

regulations or procedures addressing ethical practices and concerns.

4. Current Practices

Looking at the MOD's current practices, we find two sides of a coin. Honest practices, well-trained personnel, clear procedures and auditing agencies are one side. Unfortunately, however, a flip side that prevents the MOD procurement system from operating properly also exists.

On the positive side, the heads of the Departments and Offices conducting procurement stated during interviews that Polish Law and additional regulations governing public procurement are very strict. These regulations leave no room for personal judgment or business decisions. Detailed procedures must be followed and the MOD procurement programs follow them precisely.

According to interviewed officers, complicated and detailed procedures require the acquisition workforce to possess deep knowledge and experience in procurement procedures. This knowledge and experience help personnel avoid violating the law or engaging in misconduct.

High discipline and compliance with regulations are other characteristics that describe procurement officers. Thorough audits and severe penalties in case of procedures violations create such an environment, according to procurement officials. When interviewed, officers highlighted the intensive audits of all elements in the procurement proceedings, particularly those involving high monetary values.

Internal audits within the LFC and audits conducted by the Supreme Audit Chamber and Audit Department, MOD,

confirm these statements. In fact, one of the depots, subordinated to the LFC, conducted over 1,300 procurement proceedings in FY 01. According to the LFC procurement official, out of these 1,300 proceedings no violations were reported. Furthermore, auditing agencies reported only minor errors.

Negative factors influencing procuring are attrition and randomness when procurement personnel are appointed. Constant reforming of the Polish Armed Forces and the MOD since the 1990s has also caused instability in personnel management. Knowledge and experience, as mentioned earlier cannot be obtained within a few months. Consequently, officers were sometimes randomly appointed to positions with no consideration of their professional skills and career paths.

"The present procurement system within the Armed Forces (AF) is not clear and very often differs from the AF regulations" (Ref.12). The Public Procurement Act and the Public Finance Act are superior to the Armed Forces regulations. Therefore, detailed and sometimes very complicated procedures, which are not only intrinsic to the procurement process but which must also be followed to the precise letter of the law, require much time to complete. When exceeding the legally allocated deadline, the procurement procedure must start over. Budget constraints, the pressure of politicians and contractors also burden the overloaded workforce of the MOD procuring department.

D. POLISH INDUSTRY

On February 1, 2002, the Minister Council published a list of enterprises that have great importance for the Polish defense and economy. This list is comprised of 168 items. The list covers a broad spectrum of all fields of industry, public sectors and services (Ref.2).

Privatization in Poland started in the early 1990s. The Polish Treasury (PT) still owns 1,762 enterprises partially (less than 100% of the total shares), and 485 of them fully (100% shares) (Ref.8). Most of these enterprises conduct business with the MOD on various levels. The CEOs or the sales department heads of 14 businesses were contacted during the research for this thesis.

1. Ethical Standards

Ethical standards are not a new phenomenon for the Polish environment. From pharmacist to taxi drivers, and from lawyers to librarians have developed their own ethical standards and ethical codes beyond binding regulations.

Though ethical standards exist in different fields, and for industries that are emerging from state ownership, law and regulations are seemingly the only ethical boundaries for conducting business.

The Trade Code, the Civil Code and the Public Procurement Act are the business framework for industry. Industry CEOs and heads of the sales departments do not recognize ethics as essential elements of duties. In their opinion, the only obligatory policies that they must follow

are those laws stated specifically in the codes mentioned above.

During the interviews for this thesis, it was discovered that industry managers did not seem to perceive or to comprehend ethical concerns. Many sales managers have never heard of ethical programs existing within their own companies. Interestingly, very often they were reluctant to even discuss these issues over the phone.

One of the sales managers promised to answer the questions in writing. In return, he expected a possible favor in the future. Another manager refused to contact the researcher. Since the Polish treasury owned his company, he asked that he be contacted through the MOD, after the MOD approved the survey.

Industry managers are interested in winning contracts with the MOD and in the world of limited budgets, layoffs, international competition and bankruptcy; they are highly motivated to do everything to succeed. They often stated that business and ethics have nothing in common. For them the Trade Code is the most important guideline.

On May 7, 2002, the Ministry of Finance published a report presenting the situation of 22 companies owned by the Polish Treasury. This report covers only those companies which had completed audits; of the remaining companies, the audits are still pending. Eight of those companies are on the list of enterprises that have great importance for the Polish defense and economy. Some of the issues described in this report will be discussed in Chapter III.

2. How Industry Cooperates with the MOD

Around 14.5% of the MOD's budget will be spent on modernization in FY 02 (Ref.15). This is a significant amount for enterprises conducting business with the MOD. With the existing budget deficit and cuts in government spending, winning the MOD contracts would tremendously improve their financial position. Newly implemented regulation (Ref.9) authorizes multi-year procurements. Therefore contractors may count on three-, four- or five-year contracts.

Industry managers, during the interviews, claimed a decline in the government contracts as a result of budget cuts. In such situations, price is an even more important factor which has emerged recently, and the MOD increasingly considers price during proposal evaluation. High overhead and obsolete technologies do not lend themselves to competitive pricing of the Polish industry's products. Nevertheless industry still expects the MOD to award contracts to them.

3. Problems Encountered

The enormous financial turbulence that the Polish budget suffered at the end of FY 01 forced the MOD to suspend or terminate numerous procurement proceedings. The limited MOD spending worsened the financial status of many companies. Consequently, strong unions and stockholders increased the pressure on the CEOs and sales departments to secure MOD contracts. This created extremely strong incentives to do whatever was possible when competing for government contracts.

On the other hand, the MOD officials reported collusion and artificial price fixing, which cannot be negotiated in unlimited tendering procedure, by vendors. Producers also keep their cost and pricing data secret and are reluctant to disclose them to the MOD. Due to inherent sensitivity, it is not possible to verify these data (Ref.12).

Two producers competing for the same contract and proposing different prices is an example. They both produce subcomponents for a product and cannot manufacture the entire product independently. This practice is in accordance with the Public Procurement Act, so vendors can dictate prices (Ref.12). In this situation, proving collusion is difficult. Also, the MOD in such cases has less leverage in negotiations, which should be the most favorable aspect of the process for the MOD.

The current situation of the Polish industry is complex but some people in the MOD believe that industry has wasted the last few years. The MOD budget when wisely used is a useful tool in healing the economy. Unfortunately, the Polish industry missed this opportunity (Ref.11).

E. AUDITING AGENCIES

1. Supreme Audit Chamber

The Supreme Audit Chamber (SAC) published a report concerning corruption in Poland in March 2000 (Ref.20). Nevertheless even in light of implementing the Public Procurement Act in 1995 and clarifying the procedures, the regulations are continually violated. Malpractice,

loopholes, and abuses of special procedures allow a particular bidder to be awarded a contract.

Misusing and abusing special tendering procedures (only one offeror) was especially common when awarding contracts regarding the national defense, special public interest and national security. When combining these two procedures, procuring organizations did not have to obtain approval from the Chairman of the Public Procurement Office for single-source contracts above 20,000 Euro. The Supreme Audit Chamber (SAC) revealed examples in its report when the MOD overused these procedures.

2. Public Opinion Research Center (PORC)

In August 2001, the PORC published a survey, illustrating corruption within Polish society (Ref.17). According to this report, the general public (93%) in Poland claims that corruption is a significant problem. Since July 2000, the percentage of people thinking that this is a major problem increased from 46% to 68%.

The majority of respondents (70%) believe the government officials benefit from public functions. The percentage of respondents holding that viewpoint has increased greatly since 1995, actually increasing 11 points during 1999 alone.

Half of the respondents believe that corruption ensues from politicians of the governing parties and the opposition. Most respondents (86%) heard of government officials benefiting from public office. However, over half of the population did not reveal interest in these facts. Once again, over 50% of the population believes that law enforcement and juridical proceedings uncovered misconduct.

3. World Bank

The central feature of high level corruption appears to be close links and feedback between political and economic groups, between the public and private sector: It is reportedly a widespread practice to supply funds in return for favors" (Ref.22).

According to the World Bank, bribes are given to political parties for which favors and preferences are exchanged. These bribes can be in cash or in gifts, like cars or guarantees of future employment for an individual or his family.

The World Bank indicates that malpractice in public procurement, particularly in the government contracts, is the main source of bribes. Another example is a conflict of interest when individuals are appointed to boards of state-owned enterprises and become unethically linked to contracts awarded by these enterprises. Unregulated lobbying and the private interests of ministers undermined Parliament's ability to take effective action and curtail these practices. The Polish government took no action despite the reports of the SAC or other evidence of abuse of public funds according to the World Bank. The government's practices of assigning political appointees to mid-level administrative posts in the administration were reported as another form of high-level corruption.

The conflict of interest concept is not well recognized according to the World Bank. Even though the parliament passed laws on financial disclosure, politicians and government officials do not respect conflicts of interest concepts. Mechanisms for checking asset

declaration or eliminating conflicts of interest do not exist.

The World Bank reported misprocurements on large state contracts sometimes exceeding market prices by a factor of two or three. Corruption in procurement of services was also reported. Abuses relating to these misprocurements occurred when offerors acquired early access to technical requirements or evaluation criteria. Also favoring particular bidders and changing conditions after the bidding had started were other common problems.

Procuring organizations used various techniques to bypass the law such as adding a large contract to the small contract of a winning bidder. The World Bank reported that when government officials disclosed pricing information to the competing companies, this allowed the companies to lower the price and win a contract. Colluding bidders has also increased prices in many instances

F. CHAPTER SUMMARY

This chapter described the law and regulations binding public procurement in Poland. It focused on policies and guidelines obligatory for the MOD and the LFC. This chapter also described codes regulating the business conduct of the Polish industry. The last part illustrated the results of the Supreme Audit Chamber, the World Bank reports and the Polish society opinion regarding corruption.

Chapter III will discuss the current ethical concerns, which the MOD procurement programs have been experiencing.

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III. CURRENT ETHICAL CONCERNS

A. INTRODUCTION

According to the World Bank, Poland is a leader in its transition toward the constitutional separation of powers. Poland is clearly preceding other Central and Eastern European countries to the European Union.

Since 1989, Poland has been emerging from a centralized legislative, executive and judicial system, which was fixed with a centrally planned economy. During this transformation, the Polish public procurement system has experienced numerous incidents. The Polish media and auditing agencies have frequently exposed violations of public procurement regulations and policies.

Vulnerability to corruption is particularly great in the transition period because the former coercive power of the state has been relaxed, and the formal and informal institutions that controlled and organized corruption in the past are in decline or have been eliminated. Meanwhile, new institutions to underpin the new democratic politics, the market economy and the rule of law have yet not been created or are in their infancy (Ref.22).

B. CULTURE

Throughout its history Poland experienced numerous partitions and occupations by alien powers. "This experience has left a legacy of perceptions of the state as belonging to others, of the state as predator" (Ref.22). Therefore, the Polish society sometimes does not identify itself with the state. According to public opinion surveys,

the Polish people do not trust politicians and government officials. Clearly, nepotism plays a major role within both the Polish private and public sectors. Political or family ties are highly common in interactions between public administration and business. "Politicians are strongly linked with economic entities" (Ref.17).

The government has taken measures to curtail nepotism. Though new mechanisms of accountability exist, implementing them is complex and time consuming. Additionally, habits and culture, which have developed throughout generations in Poland, are difficult to change. About 93% out of 1,000 managers employed in Polish firms would select profit if they had to choose between ethical behavior and earnings (Ref.6). Every third manager confirmed giving bribes in the past to accelerate crucial business matters (Ref.1).

Dr. Leopold Zgoda, from Katedra Filozofii, Akademia Ekonomiczna in Krakow, stated during an interview for a business journal that an unclear system of concessions, tax exemptions, subsidies, and tenders causes corruption. Lawsuits, which drag on many years, complicate the situation even more. According to Dr. Zgoda, only about one hundred firms in Poland have defined codes of ethics (Ref.3).

Ethical conduct may be connected with risk. Risk comes from constantly changing law, especially fiscal law, unstable market, and from corruptible and dishonest government officials (Ref.3).

Recently published reports by the Supreme Audit Chamber (Ref.20) identified public procurement as being especially threatened by corruption. Incompetence was one of the main reasons why the public procurement ran into problems, but these reports pointed to instances when binding laws were violated on purpose. A "human factor" was an integral part of illegally awarded public contracts. Lack of professional training, low "ethical level," political and local connections significantly impacted the awarding of contracts.

Daily newspaper articles have provided examples of violations, but only a small number of these ended in court sanctions. Much gossip concerning public procurement has occurred during the last few years and the MOD procurement programs were not exempt from such accusations and suspicions. However in defense of the MOD, one must conclude that some of these charges seem unbelievable. This situation is not surprising, since the MOD spends a significant amount of taxes. Yet it has also rightly been noted that "public procurement may be threatened by abuses, but it is also subject to slander" (Ref.12).

C. LAW VIOLATIONS

Allegations and suspicions force the government and the MOD to audit very carefully procurement programs. The budget deficit also had a great impact on these decisions. The auditing organizations confirmed frequent law and policy abuses, which the Polish industry or the MOD committed while managing public funds.

1. Polish Industry

The Ministry of Finance (MOF) published on May 7, 2002, "The Open Report," which details the current situation in the state-owned enterprises. This report presents abuses and violations of existing laws and policies. The report focuses on problems concerning strategic planning, budgeting, and procurement. Numerous examples of conflicts of interest and unethical connections between corporate boards of directors and politicians are also included. Eight of those companies described in the report are on the list of enterprises that have great importance for the Polish defense and economy (Ref.2).

Investments between 1998 and 2001 by the eight companies mentioned in "The Open Report," did not support their core competencies. The companies acquired corporate buildings and expensive cars and invested in different market securities without conducting appropriate market research.

Findings presented in this report disclosed the following problem areas with Government-owned enterprises:

- Strategic planning, privatization, adjustment to the EU standards, unrealistic budget planning;
- Loss of strategic customers and partners, decline in revenues;

- Undertaking unrealistic projects and investments without proper market research, and often failing to protect their company's financial interests;
- Violating procurement procedures, including artificially inflating prices, procuring useless goods and services, accepting and paying invoices without recording performed work, donating and sponsoring institutions when the financial condition of the enterprise was worsening;
- Restructuring the enterprises without strategic goals, transferring profitable businesses to subsidiaries (outside the Polish Treasury oversight and control)

Among the numerous examples of unethical business dealings, the following serve as clear examples of how extensive the problem is

- The KGHM Polska Miedz S.A. (KGHM) violated policies regarding procurement of construction projects and goods and services. The KGHM awarded, without any justification, single-source contracts for services, overhauls and prefabrications in 2001. The KGHM awarded these contracts by omitting the required tendering procedures. In this situation, the supply costs increased by 10% and the overhaul costs by 8.5%.

- The Poczta Polska (PP) violated the Public Procurement Act. The PP wrongfully awarded contracts for procurement of goods and services and thereby threatened the existence of its operations.
- The Polish Information Agency (PAI) awarded numerous single-source contracts for services. The PAI also violated or omitted required tendering procedures. This agency did not conduct the necessary market research and did not safeguard its own interests when entering into contracts.
- The ZA Tarnow (ZAT) commonly breached or renegotiated contracts that had already been signed. The responsibilities of sales managers within the ZAT were redundant. ZAT also displayed a lack of partnering with strategic clients. Discretion and concealment, instead of open competition, was a factor when awarding contract.

These are a few instances that the Supreme Audit Chamber cited. Its report portrays how the Polish industry approaches ethical concerns. It is necessary to underline that this report covers government owned enterprises.

2. Ministry of Defense

Results of the Supreme Audit Chamber assessments show that the MOD abused sole source procedures when awarding contracts. The MOD procured weapon systems and everyday goods using improper procedures (Ref.20).

In July 2000, the Supreme Audit Chamber (SAC) published an audit report of the MOD's acquisition of flight jackets for which the SAC found violations of binding laws and procedures regarding the planning and executing of procurement (Ref.21).

After reviewing related records, the SAC concluded that the involved organizations and individuals violated regulations, acted dishonestly, and ignored sound business judgment. The SAC discovered that the supplier of flight jackets was selected without open competition and the price was established outside the binding regulations and public procurement policies. This audit also uncovered major gaps in required documentation.

According to the SAC, important decisions were made orally and were not properly recorded. Therefore, this audit had to be based on oral explanation and testimony. The SAC report revealed that the procurement of flight jackets violated the Polish Law and the Public Procurement Act.

The SAC confirmed that numerous major irregularities, concerning oversight of this procurement, violated the Public Procurement Act and internal MOD regulations.

D. MISCONDUCT

Numerous activities, which are organized by different military commands in cooperation with various businesses, provide evidence of close, unethical connections between those enterprises and the military. The MOD contractors actually sponsored some of these activities. Because they frequently changed the requirements for securing contracts and forced or orchestrated particular outcomes, the suspicions and charges levied against the MOD were clearly

justified. In addition, some of the officials, who may influence these programs, try to defend or justify their positions stubbornly.

Unfortunately, some decision makers often try to excuse their positions. It may indicate that they have very close associations with the industry and they try to push certain outcomes. Frequency of requirements' changes and persistency of these actions are surprising (Ref.11).

Employing military officers as members of the corporate director boards is another problem, particularly, when their military occupation is connected to the field of the company's business (Ref.11).

A further questionable example is when the Land Forces Command and other services organize "product fairs" to advertise new military systems and cooperate with the companies which are eager to sell these systems to the MOD. The AFPD's responsibility is to organize centrally such activities but unfortunately the service commands are not willing to handover this task to the AFPD (Ref.11).

Col. Nowak, the head of the AFPD, stated that politicians and even some military officials demand that contracts be awarded to specific companies. These demands, coupled with numerous press articles that have uncovered such unethical demands, prove that laws and policies violations are highly probable (Ref.12).

Additionally, numerous media reports disclosed evidence about unethical practices in avoiding military draft or abuses and fraud regarding military property. "These practices are easy to discover and fight" (Ref.12).

E. CHAPTER SUMMARY

This chapter discussed the current ethical concerns experienced by MOD procurement programs. It focused on an element of culture, which dismissed the seriousness of unethical business transactions existing within Polish society, industry and the MOD. This chapter also presented illegalities and examples of misconduct perpetrated by the industry and even by the MOD.

Chapter IV will present data collected during the research for this thesis. Additionally, this chapter will present an analysis of these data.

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IV. DATA PRESENTATION AND ANALYSIS OF CURRENT ETHICAL CONCERNS

A. INTRODUCTION

This chapter presents and analyzes data collected from the literature review and search of Polish Law, regulations, documents, Internet resources and existing MOD regulations and policies. In addition, this chapter also introduces telephone interviews with industry managers and military procurement officials.

B. INDUSTRY

The Trade Code, the Civil Code and the Public Procurement Act describe the industry business framework. According to interviews with CEOs and heads of sales departments, the laws stated specifically in the codes mentioned above are the only ethical boundaries for industry when they conduct business (Lucznik SA, WSK Warszawa-Wola, ZCH Nitrochem Bydgoszcz).

During interviews, industry sales managers stated that they had never heard of ethical programs existing within their own companies (WZM Siemianowice, Maskpol). Industry managers confirmed their singular interest in winning contracts and their high motivation to do virtually anything and everything to succeed (WSK Warszawa-Wola). They often flatly stated that business and ethics have nothing in common (ZCH Bydgoszcz).

Another industry manager stated that ethical codes may apply to foreign sales; however, regarding the MOD the Trade Code and the Public Procurement Act are the only binding regulations (Lucznik SA).

Generally, most industry managers were reluctant during interviews to discuss specific ethical issues (Mesko, Maskpol). Some of them even refused to discuss the issue at all (Dezamet SA). When asked survey questions, the industry CEOs and the sales managers reacted with surprise and astonishment. They requested a faxed or e-mailed copy of the survey and promised to answer within a few days. The researcher has never received any response.

The intense competition within the Polish industry for MOD contracts puts the MOD in a highly unfavorable position according to the Land Forces Command procurement officers. Companies that lose the MOD contract often accuse competitors and the MOD of corruption.

C. MINISTRY OF DEFENSE

The MOD procuring activities are subject to the Public Procurement Act, the Civil Code and the Trade Code. The Armed Forces Procurement Department, the major procurement organization within the MOD, acquires goods, services and authorizes construction projects in compliance with the existing binding acts and regulations and internal procedures.

Poland's binding acts and regulations precisely define the procedures, duties and responsibilities of organizations and individuals involved in public procurement; however, the Civil Code and Trade Code do not address ethical concerns, conflicts of interest or standards of conduct. They merely create a very precise legal framework for conducting business and resolving disputes.

High discipline is an essential characteristic of procurement officers. Thorough audits of all procurement proceedings particularly those involving high monetary values, and severe penalties for violations do not guarantee compliance with regulations. Audits, conducted by the Supreme Audit Chamber and Audit Department of the MOD, confirm these statements. Yet other negative factors impacting procurement management include the frequent turnover of procurement personnel and the random hiring of employees and disinterest in their qualifications.

Complicated and detailed procedures require the acquisition workforce to possess deep knowledge and experience in procurement procedures. These complicated procedures also require much more time to complete. When the legally allocated deadline is exceeded, the procurement procedure must start over. The workload is vast. For example, the AFPD conducted over 500 proceedings in FY 01, which required the same number of review boards, each consisting of at least three personnel.

D. CONFLICTS OF INTEREST

Conflicts of interest are among the greatest problems that impact public procurement. The World Bank reported that the concept of conflicts of interest is neither comprehended nor respected within politics and the industry. Nepotism plays a significant role in politics and business.

The SAC also reported various examples of unethical connections between corporate boards of directors and politicians. The MOD procurement programs witnessed instances of conflicts of interest. Military officers have

been members of corporate boards. In some cases, their military occupation has been connected to the company's business. These facts provide evidence of unethical behavior and clearly indicate the existence of conflicts of interest concerning politicians, the industry and the MOD.

E. ESSENTIAL ELEMENTS LACKING IN POLAND'S ETHICAL CULTURE, INDUSTRY BUSINESS STANDARDS AND DEFENSE REGULATIONS

Based upon the preceding facts, many industry managers clearly do not perceive or comprehend ethical concerns. In their opinion, the only obligatory policies that they must obey are the laws stated specifically in the acts and the codes previously mentioned. These acts provide general frameworks for business conduct; however, they have loopholes, and they do not include guidance regarding the specific interpretation of the procurement policies. The evidence further suggests that industry managers may be willing to exploit these existing loopholes in the binding procurement regulations and policies to win the MOD contracts.

A similar situation exists within the MOD. The Polish Law and additional regulations governing public procurement are very strict, so these regulations leave no room for personal judgment or business decisions; however, malpractice, loopholes, and abuses of special tendering allow the required policies to be ignored or omitted.

Complex procedures instill a tremendous burden on the procurement workforce. This along with a high turnover of personnel may lead to shortcuts or mistakes in the procurement proceedings. In addition, the low salaries of procurement personnel and the huge amounts of money

involved in the MOD contracts may tempt certain individuals to abuse the existing policies for personal gain.

Too many Polish acquisition officials are insensitive to ethical concerns, using the letter of law as the bottom line. In addition, a high turnover of personnel coupled with insufficient training encourages law violations. Most definitely, this lack of training causes unethical behavior.

Generally, the Polish public procurement lacks the following:

- Guidance for procurement personnel addressing standards of conduct.
- Compliance to binding policies caused by corner cutting or lack of training.
- Sensitivity to ethical concerns caused by dishonest individuals or insufficient knowledge of business ethics.
- Understanding conflicts of interest.
- A system that allows reporting and monitoring policy violations or misconduct.
- Procurement authorities that can advise on business conduct.

The product of this thesis will be a model for ethical code and business standards, reflecting the problems mentioned above. Col. Nowak, the head of the AFPD and procurement officers from the Land Forces Command, stated that the model should be simple and general because the binding policies are prescriptive. Also, this thesis

discovered facts indicating that the model should consist of broad guidance for the MOD procurement personnel instead of detailed and regulatory policies. This model could be further improved if needed.

As the evidence suggests, a lack of training might cause unethical actions, so training should be another element of this model, especially emphasizing conflicts of interest. Also employment of procurement personnel outside the MOD should be regulated. This regulation has to apply to the workforce on every level of the MOD procurement organization.

The MOD should exercise two roles: an advisory role and a monitoring role. Regarding the advisory role, there are no entities other than the chain of command where procurement personnel can seek advice in doubtful situations. Legal councils can advise on matters of legal interpretation. Ethical problems may ensue, however, even when an individual obeys the law, there may still be grey areas not defined by policies and advice should be provided in these situations.

The monitoring role of the MOD should focus on unethical practice of "double employment." For example, military officers or other government officials should not be allowed to serve on corporate boards. This clearly creates conflicts of interests. Post employment of procurement officials in enterprises conducting business with the MOD should be forbidden for a certain period of time. The issue of disclosing procurement sensitive information must be addressed because the facts show that

unethical access to information by unauthorized individuals has led to abuses.

F. CHAPTER SUMMARY

This chapter analyzed the data collected during the research for this thesis. This chapter focused on evidence of illegalities regarding business interactions between the industry and the MOD. The concept of conflicts of interest was also presented. Chapter V will present conclusions and recommendations.

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V. CONCLUSION AND RECOMMENDATION

A. GENERAL

This research analyzed the current ethical issues involved in the Polish MOD acquisition programs and will propose a Formalized Ethical Program. Additionally this thesis will develop an Ethics Program Implementation Model for the Polish MOD.

B. RESEARCH QUESTIONS

1. Primary

What is the current ethics environment within the Polish acquisition programs and given that environment, what should be the essential elements of a formal ethics program for the Ministry of Defense (MOD)?

Business interactions between the Polish industry and the MOD are not transparent. Numerous examples of violations of law or alleged abuses confirm this state of non-transparency. Old habits and expectations still exist. Culture changes very slowly and the change often requires an incredible effort of every stakeholder. The industry and the MOD must cooperate but both entities must understand that only clear, precise regulations and procedures supported by ethical guidance can enhance collaboration. On the other hand, emerging commercial and free market practices are creating a new environment for business conduct. Public confidence in Poland's acquisition system is also increasing.

2. Subsidiary

a. What specific guidance does Polish Law provide with respect to ethics, business conduct and personal standards of conduct?

The Polish Law and procurement regulations very precisely describe the procedures as well as the duties and responsibilities of public procurement personnel. The approach is extremely prescriptive, which leaves no room for interpretation or personal business judgment. Nevertheless, loopholes in existing policies create opportunities for abuses and misconduct. These acts and regulations do not address ethical concerns, which should ensue when business is conducted in the currently complex Polish environment.

As a result, the Office of the Public Procurement calls for developing and implementing an ethical code for public procurement organizations. The office initiative; however, was limited only to mentioning this need in a report on "Pathologies in Public Procurement" (Ref.18).

b. How does the MOD implement and regulate ethical conduct within its acquisition personnel and defense contractors?

The "General Regulation," the Military Service Act, the Discipline Act, and the Financial Responsibility of Military Personnel Act address standards of conduct in a very brief manner. The last two acts primarily describe procedures and forms of punishment in case laws and

regulations are violated. The Civil Code and the Trade Code also govern the MOD acquisition programs.

The only guideline addressing ethical concerns within the MOD procuring organizations is the Code of Professional Responsibilities implemented by Col. Nowak, the head of the Armed Forces Procurement Department. It is not clear yet how sufficient the Code is. It was implemented a few months ago and there was no data available to evaluate sufficiency of the Code.

Generally, the MOD does not clearly communicate their interest in ethical standards when cooperating with industry even though laws and policies regulate this cooperation. When it benefits the MOD, they often overlook these regulations.

c. How does the Polish industry approach ethical issues when conducting business with MOD?

The obligatory policies binding for the industry are the Trade Code, the Civil Code, the Public Procurement Act and those laws stated specifically in the codes mentioned above. The industry managers did not seem to perceive or to comprehend ethical concerns. In fact, most industry managers seem oblivious of ethical programs existing within their own companies.

d. What ethical issues currently ensue during industry and MOD procurement?

The limited MOD spending worsened the financial status of many companies. Stockholders increased the pressure on the CEOs to secure MOD contracts. This created extremely strong incentives to do whatever was possible when

competing for government contracts often at the expense of ethics. Thus MOD officials have reported collusion of potential contractors and artificial price fixing.

Huge disparities exist between the low salaries of procurement personnel and the huge amounts of money involved in the MOD contracts. These disparities threaten to undermine the integrity of procurement officials.

Military officers who serve as members of corporate boards, especially when their military occupation is connected to the company's business raise further suspicions of unethical behavior.

e. Based upon the current situation in Poland, what should be the essential elements of an MOD ethics program?

The research, which was conducted for this thesis, indicates that an ethics program for the MOD should consist of the following elements (a more detailed discussion of these elements is contained in Appendix 1):

- General guidelines that address laws and policies
- Education on and the elimination of conflicts of interest
- Training on current ethical concerns
- The dissemination of information regarding unethical conduct
- Effective reporting procedures
- Advisory role of the Armed Forces Procurement Department
- Auditing functions

C. RECOMMENDATIONS

The MOD procurement programs must develop and implement a formalized ethics program. However, owing to the unique legal and cultural factors, and the absence of any ethical programs in the Polish public procurement, any proposed program should simply guide business conduct.

The MOD should develop an ethical code and implement formalized Ethical Conduct Program within the MOD procurement organizations. This formalized program must emphasize conflicts of interest, since this concept is recognized neither among military officials nor among the acquisition workforce.

To avoid suspicions and allegation, the MOD must clearly adopt standards within its own procurement organizations when interacting with potential contractors.

The ethical code, supported by appropriate training, would help the MOD impose principles of ethical business conduct. This code would also clearly communicate the MOD's acceptable standards of ethical business practices.

The MOD should regulate employment of the procurement officials by companies that conduct business with the MOD. The recommended amendment should specify procurement positions and time periods regarding post employment of procurement personnel.

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APPENDIX

THE ELEMENTS OF A PROPOSED MODEL FOR AN ETHICAL CODE AND BUSINESS STANDARDS

General Guidelines for the MOD procurement personnel:

- Follow binding laws and regulations regarding public procurement.
- Follow the MOD internal procedures governing public procurement.
- Act professionally by being objective and honest.
- Report ethically doubtful behavior or procedures.
- Report possible conflicts of interest, and request exclusion from evaluation or solicitation activities if such conflicts exist.
- Do not disclose sensitive information regarding procurement proceedings to any unauthorized party.
- Do not accept any gifts of any form from potential contractors or other parties.
- Avoid the appearance of unethical conduct

Advisory Role of the MOD:

- Advise procurement personnel on necessary legal ethical issues.
- Advise procurement personnel on post-employment issues.

Training:

- Analyze any ethical problems encountered.
- Provide feedback regarding problems reported or experienced.
- Clearly communicate lesson-learned conclusions to procurement organizations and individuals.
- Emphasize the ethics of conflicts of interest.
- Include the following topics in the MOD's ethic program:
 - Laws, regulations and policies.

- Distinction between legal, illegal, ethical and unethical conduct.
- Business ethics.
- Conflicts of interest.
- Sharp business practices.
- Risk management.
- Fraud and fraud indicators.
- Ethics monitoring and oversight and controls and audits.

Monitoring Role of the MOD:

- Regulate and monitor employment of procurement personnel outside the procurement organizations.
- Monitor procedures concerning the disclosure of procurement sensitive information.
- Implement and monitor a training program that emphasizes business ethics.

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